HISTORY OF THE "PRUDENT MAN" RULE

1. Harvard College v. Amory, Supreme Judicial Court of Massachusetts, 1830

All that can be required of a trustee to invest is that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested.

2. ABA Statement of Principles of Trust Institution, 1933

The investment function of a trustee is care and management of property, not mere safekeeping at one extreme or speculation at the other. A trust institution should devote to its trust investments all the care and skill that it has and can reasonably acquire. The responsibility for the investment of trust funds should not be reposed in an individual office or employee of a trust department. All investments should be made, retained or sold only upon the authority of an investment committee composed of capable and experienced officers or directors of the institution.

3. Scott on Trusts, 1939

The only general rule which can be laid down as to investments is that the trustee is under a duty to make such investments as a prudent man would make of his own property having primarily in view the preservation of the estate and the amount and regularity of the income to be derived. In various forms this rule has been stated in innumerable cases. It involved three elements, namely care, skill and caution. The trustee must exercise a reasonable degree of care in selecting investments. He must exercise a reasonable degree of skill in making the selection. He must, in addition, exercise the caution which a prudent man would exercise where the primary consideration is the preservation of the funds invested.

4. Model Prudent Man Statute, Louis S. Headly and Mayo A. Shattuck, 1942

In acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for the benefit of another, a fiduciary shall exercise the judgment and care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.

5. ERISA (The Federal Prudent Man Investment Law), 1974

A fiduciary shall discharge his duties ... with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims ... by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so, and ... in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title.

VARIATIONS IN STATE PRUDENT INVESTMENT STATUTES

New Jersey State Statute since March 3, 1976

In investing and reinvesting money and property of a trust estate and in acquiring, retaining, selling exchanging and managing investments, a fiduciary shall exercise care and judgment under the circumstances then prevailing, which persons of ordinary prudence and reasonable discretion exercise in the management of and dealing with the property and affairs of another, considering the probable Income as well as the probable safety of capital. If the fiduciary has special skills or is named as the fiduciary on the basis of representations of special skills or expertise, he is under a duty to exercise those skills. (The list of classes and kinds of legal investments has been retained, but the mix of "legals" and "nonlegals" is no longer 60%-40%, but that which a "prudent person" would select.)

New York State Statute since May 1, 1970

A fiduciary holding funds for investment may invest the same in such securities as would be acquired by prudent men of discretion and intelligence in such matters who are seeking a reasonable income and preservation of their capital, provided, however, that nothing in this subparagraph shall limit the effect of any will, agreement, court order or other instrument creating or defining the investment powers of a fiduciary, or shall restrict the authority of a court of proper jurisdiction to instruct the fiduciary ... (No legal list of investment was retained with the enactment of this statute.)

Michigan State Statute - October 14, 1955

"... as an ordinarily prudent man of intelligence and integrity, who is the trustee of the monies of others, would purchase, in the exercise of reasonable care, judgment and diligence, under the conditions existing at the time of purchase, having due regard for the management, reputation and stability of the issuer and the character of the particular securities: provided, however, that no such funds shall be invested in any securities or property purchased from said trustee, whether a person or a corporation, or from any subsidiary or affiliate of said corporation."

EXAMPLES OF CASE LAW
Interpretations of the "Prudent Investment Law" In New York

The Spitzer Decision (New York State Court of Appeals, 1974)

Plaintiff claimed certain individual holdings within a portfolio were improperly managed by the trustee. Defendant (trustee) claimed proper management as reflected in good overall performance of the portfolio. Court found with plaintiff:

1. Overall increase in value of a portfolio does not insulate a trustee from responsibility for imprudence or negligence with respect to individual investments therein.

2. Interested parties cannot pursue remedies for "paper" losses, but must wait until these losses are realized.

3. A fiduciary is not required to be infallible, but cannot act carelessly or negligently at the time of selling or retaining trust assets.

Summary: There will always be losses and a trustee has substantial burden to show freedom from carelessness and negligence. Therefore, a trustee must be prepared to show a documented, adequately reasoned investment record for each investment, and not rely on overall performance of a portfolio as proof of prudent investment management.

The Morgan Guaranty Trust Company Decision (New York County Surrogate, 1977)

Plaintiff claimed lack of cue and diligence on the part of the trustee bank evidenced by poor investment performance. Defendant (bank) claimed prudent management throughout the period that the assets were under its control and provided detailed records and files as proof. Court found with defendant:

1. The principal of a trust is always at risk.

2. All that can be expected of a trustee is that it employ such diligence and prudence in the management of trust assets as prudent persons of discretion and intelligence in such matters used in their own affairs.

3. Prudence of conduct, not performance of investment, is the test of a trustee.

4. Prudence is tested at the time of investment decision, not from the vantage point of hindsight.

Summary: The trustee in this case demonstrated prudent management as reflected in elaborate formal committee proceedings and extensive investigations and considerations, i.e., review and analysis of major industries, as well as individual companies, application of statistical services and the use of reports, trade publications and other public information.

It should be noted that decisions in one jurisdiction will most probably be used as precedents, not only in that jurisdiction, but in others as well.